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General Business Conditions

THE rise in industrial activity has continued into February, following the now familiar pattern of sizable advances in steel and automobile production and in construction. In most other lines the gains were still moderate and scattered. The over-all rise in production during February may not have been much, if any, greater than the 2 or 3 per cent seasonal upswing which ordinarily occurs at this time of year. This would imply a seasonally adjusted Federal Reserve index close to the January level of 131 (1947-49 = 100). The rapid pace of the advance in production during the final quarter of 1954 obviously could not be maintained indefinitely, and a leveling out of the index will not come as a surprise.

Steel mills pushed their operations in the last week of February to 90.8 per cent of capacity from the average January rate of 82.7 per cent. In some regions, the operating rate is once more testing capacity. Automobile manufacturers, in their drive for increased production and sales, stepped up passenger car output to a new weekly peak of 173,500 in mid-February, and March schedules threaten the record of 720,000 cars produced in June 1950. The sales achievement on 1955 models has surprised almost all observers. According to Ward's Automotive Reports, retail car sales passed the one million mark in late February, nearly a month earlier than in 1954.

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Recovery in Production and Employment

The continued strength in the steel and auto industries in recent months has been impressive. For the rest of the first half they give every indication of strongly supporting, although probably not actively expanding, the level of industrial production. A sound recovery cannot be based solely on two or three industries.

Improvement, however, has been widespread. Every one of the major manufacturing and mining groups had, by early 1955, risen above its 1954 low point. In other words, there is none still on the down-grade. Only two groups, "food, beverages, and tobacco," and "nonelectrical machinery" (which includes farm machinery, machine tools, and other industrial and defense equipment), are barely above their 1954 lows. Some industries have advanced spasmodically. Others have surpassed their 1953 peaks and gone on to set new production records: transportation equipment, building materials, paper and printing, chemicals, and petroleum production and refining.

Factory employment has not yet matched the rise in production. Last August, both industrial production and manufacturing employment were at their lowest level for 1954 (seasonally adjusted); by January 1955, production had risen 6½ per cent but employment was up only 2 per cent. The lag in re-employment is a natural one. Manufacturers have been taking up the slack

in their operations, both through lengthening the work week and increasing the efficiency of their operations. To the extent that management was reluctant to lay off skilled help a year ago until they were more sure of the dimensions of the decline, they have been equally reluctant to add new workers until the strength of the upturn becomes clearer.

In the past year, many firms have found their earnings squeezed between mounting costs and price-conscious customers. They have found, in numerous cases, that the economies and improved techniques introduced during a recession to ease pressure on the cost side often do not really begin to pay off until production picks up again. As more normal production and work schedules are achieved, productivity improves.

Renewed Inventory Accumulation

Part of the current advance in production, particularly in the automobile and steel industries, appears to be going into rebuilding depleted inventories. At the end of 1954, business inventories generally were still declining, although the inability to supply goods fast enough to meet December's recording-breaking retail demand was probably more of a factor than deliberate inventory liquidation. More recently, trade sources indicate an increase in the stock of steel in process all the way from ingot to finished product — a natural consequence of stepped-up activity. But with delivery dates being pushed further ahead, purchasing agents feel their stocks of some items are still on the low side.

This somewhat longer view of procurement has not reversed the cautious buying policies and careful inventory control of last year. Even the prospect of strikes and the international developments of the past month — the changed Russian administration, the French cabinet crisis, and the heightened tension around Formosa — did not touch off a scramble for inventories. But for people who have been looking skeptically at the second half of 1955 these events underline the uncertainties always present in the international situation.

During January close to one fifth of the passenger cars produced went into dealers' stocks. This tendency appears to have continued into February, and by the end of the month, stocks were expected to run between 550,000 and 600,000. However, retail sales of new cars have been maintained at such a pace that not until mid-February had stocks of 1955 models been built up to the traditional level of one month's sales. Helped by heavy automobile sales, over-all retail sales in January were 10 per cent above January last year and, on a seasonally adjusted basis, stayed within 1 per cent of the record December sales.

The Homebuilding Boom

Perhaps the most striking development contributing to recovery and demanding more labor and materials has been the acceleration of construction, particularly the building of homes. Even before the latest surge in homebuilding, many persons were concerned about the high rate of housing construction. They wondered how much longer people would continue to buy a million or more homes a year; also about the increased volume of mortgage debt and the easy terms on which much of it was extended.

In the war and early postwar period, the number of marriages and new families formed tended to outrun the rate of homebuilding. The gap was filled temporarily in a variety of ways, including doubling-up with relatives, temporary housing, and conversion of existing buildings into apartments. Now the tables have turned. The marriage rate has slackened because of the smaller number of persons born during the Great Depression and now reaching marriageable age. The number of new households formed in the three years ended April 1954 was about 2.2 million, while the number of new dwelling units started in the same period totaled 3.3 million. This excess of a million or more dwellings in a three-year period reflects the degree to which the present market depends upon upgrading and replacement of the nation's stock of housing.

A market based on upgrading of family tastes in housing is more vulnerable to contraction in income or credit than one based on the pressure of population growth and family formation. Nevertheless, replacement demand is strong, involving such factors as the growth of the suburbs, the shift from renting to home ownership, demolition or re-conversion of temporary dwellings, rehabilitation of blighted areas, and the restoration of more normal vacancy ratios. The demand is evidenced not only in new starts but in generally sustained resale prices of residential property, the continuing rise in rents, and the stability of vacancy ratios in rental units.

A homebuilding boom can kill itself off by over-estimating the market, inflating costs to a point where the buyer rebels, or making excessive demands for credit. Federal Reserve policy in recent months has shifted from active ease to a more neutral type of policy. Under this policy bond prices have tended to drift lower, moderat-

ing the press of funds into mortgage investments. Nevertheless, the shape of residential construction activity for months ahead has already been largely determined by the number of mortgage commitments made by lenders, the contracts signed, the building permits granted, and the work already under way.

Corporate Earnings in 1954

Annual reports for 1954 recently issued by corporations representing all major lines show that despite the moderate reduction in over-all business activity as compared with 1953 a high level was maintained generally in the dollar value of sales or revenues, in net earnings, and in dividends paid. Declines in pre-tax earnings were largely offset by lower federal income taxes payable and by expiration of the excess profits tax at the end of '53. The reports appear to be turning out considerably better than was expected because of the vigorous recovery that occurred in the fourth quarter.

Our tabulation of the statements issued to date by 2,392 corporations shows combined net income after taxes approximately the same as in 1953 – $10.8 billion against $10.4 billion, an increase of 4 per cent. The number of companies having increases exceeded somewhat the number with decreases. The condensed summary shows the trends by main industrial divisions.

Preliminary Summary of Net Income of Leading Corporations for the Years 1953 and 1954

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1953	Reported Net Income After Taxes 1954	Per Cent Change
112	Food products	$ 334,636	$ 326,822	— 2
37	Beverages	94,740	94,765	+—
15	Tobacco products	126,629	135,596	+ 7
75	Textile products	126,926	79,580	—37
21	Clothing and apparel	10,933	8,627	—21
21	Shoes, leather, etc.	27,129	27,357	+ 1
18	Tires, rubber products	183,464	169,195	— 8
25	Lumber, wood products	33,908	33,342	— 2
53	Paper and allied prod.	194,859	208,961	+ 7
46	Chemical products	581,070	686,968	+18
24	Drugs, soap, cosmetics	129,855	160,379	+24
17	Paint and varnish	31,661	35,110	+11
51	Petroleum prod. & ref.	1,422,862	1,429,860	+ 1
57	Cement, glass, stone	189,045	229,309	+21
40	Iron and steel	713,674	624,009	—13
379	Other metal products	1,188,747	1,298,322	+ 9
82	Transportation equip.	920,646	1,097,088	+19
58	Misc. manufacturing	81,450	93,245	+14
1,131	Total manufacturing	6,391,729	6,738,035	+ 5
16	Coal mining	8,228	D-*2,125*	——
10	Metal mining	24,182	21,526	—11
7	Other mining, quarry.	40,652	49,214	+21
33	Total mining, quarry.	73,062	68,615	— 6
19	Chain stores—food	67,749	79,502	+17
35	Chains—variety, etc.	103,412	94,748	— 8
38	Department & specialty	91,807	88,534	— 4
31	Wholesale and misc.	49,873	56,703	+14
123	Total trade	312,841	319,487	+ 2
129	Class 1 railroads	868,000	666,000	—23
44	Other transportation	54,905	50,244	— 8
173	Total transportation	922,905	716,244	—22
155	Elec. power, gas etc.	868,736	950,997	+ 9
51	Telephone & telegraph	540,388	614,610	+14
206	Total public utilities	1,409,124	1,565,607	+11
16	Amusements	23,105	33,026	+43
20	Restaurant and hotel	3,059	3,570	+17
26	Other business services	44,753	50,862	+14
10	Construction	17,377	13,978	—20
72	Total amuse., ser., etc.	88,294	101,436	+15
340	Commercial banks	660,671	705,298	+ 7
22	Fire & casualty insur.	52,180	58,729	+13
175	Investment trusts	282,938	330,565	+17
63	Sales finance	154,633	170,676	+10
54	Real estate	9,086	13,397	+47
654	Total finance	1,159,508	1,278,660	+10
2,392	Grand total	$10,357,463	$10,788,084	+ 4

D-Deficit

The favorable effect on the full year's earnings of the rebound in the final quarter is indicated by figures available by quarters for 494 manufacturing companies. These show the December quarter net income 25 per cent above the September quarter, and 20 per cent above the December quarter of 1953. Railroad earnings, off 39 per cent in the first nine months, were down 23 per cent in the full year.

Annual reports of 1,131 manufacturing companies were divided about equally between those having increases or decreases in net income, the total of which was up 5 per cent. Analysis of the income accounts of the larger companies thus far reporting indicates that dollar sales billed last year were down 7 per cent. Operating expenses were reduced to a somewhat smaller extent, and there was a decrease in pre-tax earnings of 12 per cent which, together with expiration of the excess profits tax, resulted in a cut of 25 per cent in federal tax liabilities. Such taxes still absorbed an average of 50 per cent of the pre-tax balance last year, against 59 per cent in 1953.

Those lines where volume of sales receded materially last year were affected most seriously by such adverse general factors as the return of keener competition with the passing of shortages and sellers' markets, and the persistently upward tendency of operating and overhead costs. Despite the continuing high level of corporate earnings in the aggregate, the number of business failures last year according to Dun & Bradstreet's statistics totalled 11,086, a jump of 25 per cent over 1953 and the highest since 1941. The liabilities involved in failures totalled $462,628,000 last year and were up 17 per cent to the highest level since 1933.

In the public utility field most companies supplying electric, gas, telephone, and other services reported a continued growth in operating revenues and net income. In the trade groups the changes were mixed, with total net income up slightly. Not yet available for this

preliminary summary are the figures of many important organizations in the food, petroleum, aircraft, nonferrous metals, retail trade, and other lines. Reports to be issued during March will be included in the detailed summary in our April issue, which will show earnings by 70 major groups together with average rates of return on net assets and profit margins on sales.

Cash dividend payments by all U.S. corporations rose 8 per cent last year to set a new high record, according to the Department of Commerce computations.

Rise in Depreciation Charges

An important factor to consider in interpreting the corporate earnings reports issued this year, particularly in the manufacturing industries, is the increasingly heavy charge to expense being made by many companies for the depreciation of their physical properties due to wear and obsolescence. Such charges already were rising sharply because of the great expansion made during recent years in the cost of plant and equipment on which they are based. In addition, current charges include accelerated depreciation rates on defense facilities as permitted by law, plus stepped-up regular rates as authorized by revisions in the Internal Revenue Code of 1954. It had been a widespread complaint of business men that frequently the former tax provisions were unrealistic because of the long life estimates on property and the resultant low rates of permissible write-off.

To the extent that rates for amortizing the cost of property are increased, they reduce the pretax earnings, the taxes, and the balance after taxes. In the case of many leading companies producing steel, nonferrous metals, chemicals, and military equipment generally, such charges have since prewar days expanded several-fold and often exceed total dividend payments. The effect of accelerated depreciation and postponement of income taxes to later years is to lower the currently reported net income available for dividends. It also hampers comparison with prior years and affects the relationship studied by investors and analysts between stock prices and earnings.

Because of this temporary effect on the figures, some companies as a matter of information to shareholders have adjusted their published income statements to a basis of standard depreciation charges and income tax liabilities, while others have given out supplementary figures that are so adjusted.

For all U. S. manufacturing corporations, numbering around 120,000, annual depreciation charges have increased from approximately $1.6 billion in prewar 1939 to $6.8 billion last year or by more than four-fold. During that period the year-end balance sheet valuation of gross property account rose from around $41 billion to $121 billion as a result of the vast expansion and modernization of plant and equipment and the higher cost of such facilities. Accrued depreciation reserves, however, went up by $37 billion, so that net property account after deducting such reserves rose by only $43 billion. An accompanying summary gives the figures as reported by the U.S. Treasury, Securities & Exchange Commission, and Federal Trade Commission.

Property Accounts and Depreciation Charges of All U.S. Manufacturing Corporations

(In Billions of Dollars)

Years Ended Dec. 31	Gross Prop. Acc't-a	Accrued Depre. Res.-b	Net Prop. Acc't-a	Annual Depre. Chges-b	Deprec. Chges to Prop. a/c Gross	Net
1939	$41.6	$18.5	$23.1	$1.6	3.9%	7.1%
1940	42.7	19.1	23.6	1.7	4.1	7.3
1941	44.9	20.2	24.7	1.9	4.3	7.9
1942	49.1	22.5	26.6	2.3	4.8	8.8
1943	51.6	24.6	27.0	2.7	5.3	10.1
1944	52.0	26.1	25.9	3.0	5.7	11.5
1945	53.9	28.7	25.1	3.5	6.6	14.1
1946	59.2	29.7	29.4	2.4	4.1	8.3
1947	66.8	31.4	35.4	3.1	4.7	8.8
1948	74.0	32.8	41.2	3.9	5.2	9.4
1949	79.1	35.0	44.1	4.1	5.2	9.2
1950	83.3	36.9	46.4	4.4	5.3	9.6
1951	92.1	39.5	52.6	5.3	5.7	10.0
1952	100.6	42.8	57.7	6.0	6.0	10.4
1953	112.6	50.2	62.4	6.3	5.6	10.0
1954-e	121.0	55.0	66.0	6.8	5.6	10.3

Sources: U.S. Treasury annual "Statistics of Income" for 1939-52; S.E.C. — F.T.C. "Quarterly Financial Report" for 1953-54. a-Includes land. b-Includes amortization charges on defense facilities, and depletion charges on natural resources of minerals, petroleum, etc. e-Fourth quarter 1954 estimated.

Whether or not depreciation charges are too big, too small, or just adequate is, of course, a question that never can be answered by generalization based on composite statistics. There are literally countless differences among different industries and individual companies in their character of business, type and capacity of properties, accounting practices, and so on. Often little relationship appears between the year-to-year changes in the net depreciated valuation of a plant as carried on the balance sheet, the actual productivity in terms of physical units, and the total volume of sales billed in dollars.

Those companies permitted to charge depreciation on a five-year basis may find that the useful life of the property will prove to be several times that long; however, in the later years no further charges will be available as allowable deductions, so that both earnings and taxes will increase correspondingly. The total permissible depreciation credit is the same regardless of whether a company uses standard or accelerated

rates. Fast amoritzation, however, helps to finance the early replacement of obsolescent equipment.

While the problem of higher replacement costs is an inevitable aftermath of wars and price inflation and continues to plague business for many years, its seriousness tends, fortunately, to diminish gradually as time goes on. When new capital outlays are made year after year at the prevailing higher levels of prices — particularly when the outlays are of such magnitude as those since World War II — the gross property account comes to reflect the earlier years less and the recent years more. Likewise, the annual depreciation charges, computed as a fixed or varying percentage of historical costs, also tend to reflect more closely present-day prices.

Annual depreciation charges as shown in the table are not only far above those of earlier years in dollar total but also are at higher rates relative to property valuations. For example, in the four years 1951-54 the depreciation charges, which include also amortization charges on defense facilities and depletion charges on natural resources, were at a rate of about 5½ per cent annually on the year-end gross property valuation; this compares with a rate of only about 4 per cent in 1939-40. At current rates the properties would be completely charged off, on an average, in about eighteen years, compared with twenty-five years prewar. Such charges computed on net property valuation were at a rate of about 10 per cent annually, compared with only 7 per cent prewar.

An Internal Source of Funds

Aside from their influence on reported earnings, depreciation charges are important because they constitute an increasing "internal" source of funds for financing business. This is due to the fact that they are an expense item involving no cash outlay at the time but representing instead the recovery, in piecemeal fashion, of the original capital investment in plant and equipment. In other words, even if a company reported no net profit on operations it would, theoretically at least, experience a gain in cash holdings by the amount of its depreciation charge — assuming no capital outlays or other special transactions affecting the cash flow.

This means that American corporate industry now has more than $6 billion available annually to use together with retained earnings for financing its future requirements of plant investment plus working capital. Industrial rebuilding and expansion in the past few years have been financed to a major and still rising extent by these mounting depreciation charges. They hold down the amount of outside money required for growth and permit a larger portion of current earnings to be paid out in dividends.

Britain Applies the Brakes

For the past several months British bankers and other thoughtful observers have been warning of rising costs and other inflationary symptoms beginning to show up in the economy. In Britain, as on the Continent, wage demands have been appearing more frequently and insistently. With consumer purchasing power expanded by full employment and rising incomes, with the gradual relaxation and final abandonment of rationing, and with the removal of instalment credit curbs since last summer, the British public has been on a real spending spree. This, combined with record exports last year and the high rate of investment in new housing and industrial re-equipment and expansion, has put increasing strain on the country's resources. More recently, weakness in sterling together with a tendency over the past few months — emphasized in the January trade figures — towards a narrowing of the balance of payments surplus, has reawakened concern over the exchange position.

The action by the Bank of England on January 27 in raising its discount rate from 3 to 3½ per cent represented a move by the authorities to apply the traditional monetary brake on the booming economy and its tendency to inflate home demands for products that might otherwise be exported. In confining the initial rate increase to one half of 1 per cent, as against the usual practice of advancing by 1 per cent stages, the authorities were giving what a Bank of England spokesman described as "a moderate amber light" against inflationary tendencies.

Evidently not satisfied with the results of this first move, the Bank on February 24 followed through promptly and decisively with the customary full 1 per cent rise, from 3½ to 4½ per cent. At the same time the Chancellor of the Exchequer, R. A. Butler, announced the reinstatement of instalment credit restrictions and a broadening of the authority of the Exchange Equalization Account to operate in the transferable sterling market.

With respect to the latter move, it may be explained that there has apparently been a considerable loss of dollar exchange to Britain in recent months through commodity shunting operations in transferable sterling. With the

wide spread in the official quotation for sterling and that for transferable sterling, such operations have been profitable, but if the Exchange Equalization Account is permitted to mop up some of these transferable funds, shunting operations will not be profitable and deals will be done through the regular channels to the benefit of the U.K.'s currency reserves.

Impact on Security Markets

The higher Bank rate and new credit restrictions have given a rude jolt to the London security markets, both stocks and bonds.

For some time the British share markets have been fed on a rich diet of bullish developments, and after the big rise of the past year and a half it is not surprising if they got into an overbought condition. Besides lower interest rates and exuberant business activity, British stocks, like American, benefitted last year from expiration of the corporate excess profits tax. In Britain this tax, imposed originally on January 1, 1952 in connection with rearmament and the balance of payments crisis of 1951-52, expired December 31, 1953. The press has been full of exhilarating stories of projected large scale capital expenditures by private industry and public authorities, and — last but not necessarily least — hopes have been riding high recently for some additional tax relief in the new budget.

Nourished by these strong bullish influences, the rise in British industrials reached a point early this year where the yield on blue chip issues was down to within ½ of 1 per cent of that obtainable on long-dated government bonds. Voicing the soberer judgment of the financial community, the Chairman of the Midland Bank, Lord Harlech, in his annual statement to the shareholders made public January 25, referred to prevailing prices of equity investments as "heavily" discounting the prospects of continued high activity in industry and trade, a further growth of business profits and larger distributions therefrom.

The immediate stock market reaction to the first rise in the Bank rate was to give prices a further upward push — apparently reflecting a mixture of relief over the mildness of the action taken and optimistic interpretations of the move with respect to the business outlook and chances of tax reduction. With the failure, however, of sterling to rally and statements by the Chancellor leaving no doubt of his concern over the foreign trading position, the mood quickly changed and stocks broke sharply. In the space of 20 days the drop clipped some 19 points off the London Financial Times' index of 30 leading industrial shares, reducing that index from a peak of 198 (1935 = 100) on February 3 to 179 on the 22nd.

With the second step-up in the Bank rate and re-introduction of consumer credit controls on February 24, fresh selling broke out, carrying the stock price index to a low of 177. This represented an overall decline of 21 points, or 11 per cent, from the February high. The index was still 50 per cent above the level in mid-1953.

Prices of gilt-edge bonds, which had been slipping even before the Bank rate changes, were likewise hit hard. The widely-held War Loan 3½s declined from 86 to 80. Later, both stocks and bonds rallied from the lows. At the close of the month American account sterling was firmer at \$2.78¾, while transferable sterling strengthened from around \$2.71 to \$2.75.

Depression Fears Unwarranted

From the foregoing account of events leading up to the London stock market break, the reasons for the slump would seem to be fairly clear. Most obvious has been the need for readjusting stock prices in line with the new level of prices in the gilt-edge market and with more down-to-earth appraisals of the business outlook, especially in view of the new monetary policies. A potent influence in the background has been the waning hope for tax reduction in the present setting when the Government is deeming it essential to institute vigorous measures to head off inflation.

The situation also has political overtones. It raises a question as to the effect upon the fortunes of the Conservative Party of having to adopt, in what may be an election year, measures bound to be unpalatable to a great many people.

To conclude, however, that what has happened in London signals an industrial depression would be unwarranted. The setback in British securities has not been caused by Britain or other European countries running out of things to do. Actually, the amount of work to be done in the modernization and expansion of industry, in the construction of new roads and municipal facilities, and in supplying the rising demands of the people for better housing and more of the other amenities of life is immense. All this is, indeed, just beginning.

Examples of this in Britain are two major development programs announced by the Government only within the past two months. For fifteen years, since the start of World War II

in 1939, few new roads have been built in that country. Now at last, it was revealed last month, the Government is about to launch a four-year road development and improvement program to cost a minimum of £147,000,000 ($411,600,000). This follows the Government's announcement in January of plans to modernize the nationalized railway system over the coming fifteen years at a cost of £1,200,000,000. Still another major project, revealed last month by the British Iron and Steel Board, planning body for the industry, contemplates expenditure of £300,000,000 in enlarging capacity, to be completed in 1958.

These plans, and others involving the expenditure of large sums of money in the next few years, will provide years of work for the industries directly and indirectly affected.

A Courageous Course

The trouble in Britain, and perhaps in other Western European countries, has been in trying to do too much too soon. What the British authorities are aiming at in the measures they have taken was summed up in the following words from an address by Mr. Butler on February 11 after the first increase in the Bank rate:

> We want our economy to expand as fast as possible, but not faster than our capacity to pay the bigger import bill that our home expansion presents to us. So a hand must be kept on the reins, even a gentle tug given now and then to keep us on the straight path.

That the "gentle tug" could, if necessary, become a stronger pull was brought out by the stiffer controls announced soon afterwards and by the Chancellor's statement at that time. Mr. Butler emphasized that Britain's economy was fundamentally stronger than it had been at any time since World War II and that its industrial base was sound. Explaining, as he had done before, that the steps taken were designed to moderate excessive internal demands so that increasing imports due to rising production would be matched by a corresponding upswing in exports, he went on to declare, "I am determined not to allow an unhealthy position to develop in which the very prosperity we have enjoyed should have unhealthy effects on our balance of payments."

The British Government and Central Banking authorities have set a courageous course, and one that sets an example for governments, central banks, and others responsible for the formulation of public policy everywhere.

The "Unemployment Problem"

Last month the Congressional Joint Economic Committee, under the chairmanship of Senator Douglas, held its regular annual hearings to review the President's Economic Report and the economic situation and outlook. The prospects for accelerating activity, noted in the President's report, were endorsed by most of the economists called upon to testify. On the other hand, witnesses of the full employment school of thought criticized the report for failing to recommend enough new government spending programs or tax reductions to swell the federal deficit and insure "jobs for all".

While a rise in employment and production this year was almost universally expected, a number of witnesses expressed doubts that unemployment, which is figured to have averaged 3,230,000 persons (5 per cent of the civilian labor force) in 1954, would be reduced in 1955. Trade union spokesmen, echoing what their leaders have been saying in public speeches, warned of a growing unemployment problem, basing their case on a calculated "normal" increase in the available civilian labor force of perhaps 750,000 persons this year, planned releases of men from the armed services, and labor-saving inventions embodied in the term "automation".

Leon H. Keyserling, who was chief economic adviser to President Truman, vigorously supported this line of argument, warning that the nation is in a "long-term trend of rising chronic unemployment". Professor Alvin Hansen of Harvard, well-known for his theories of industrial stagnation and advocacy of government deficits, disparaged the recent recovery in business as "slight" and denied that there existed "any solid ground for believing that we are on the way back to our growth track." Advocating "utmost ease" in money and credit during 1955, he suggested that a general price increase is not injurious if there is a larger percentage advance in output than in prices.

The testimony revived memories of economic theories developed to explain mass unemployment during the decade of the 1930's. Now "automation" supplants "technocracy" as the one-word description of the rise of productive efficiency. "Chronic unemployment" takes the place of "stagnation", which somehow seems out of place in an economy making new records almost every year. The Federal Government twenty years ago applied its vast spending, taxing and borrowing powers in an effort to deal with unemployment levels running from 15 to 25 per cent of the available labor force. These efforts did not put us back on "our growth track"; they suppressed the private enterprise and investment that underlies progress toward the easier and more abundant life.

The AFL, which last month completed negotiations to merge with the CIO, already seems to have merged its economic thinking with the CIO's. Both groups take an alarming view of the future of the country unless Government acts to boost consumer purchasing power. Meeting at Miami Beach a month ago, the Executive Council of the AFL warned that unemployment might reach a peak of 4,000,000 persons in the next eight weeks. Stanley H. Ruttenberg, Director of the Department of Education and Research of the CIO, has indicated a rise in unemployment to 4,000,000 or 5,000,000 in 1955. Leon Keyserling has said that the "true" level may reach 6,500,000.

The Recent Record

It becomes a matter of common concern – to business, agriculture, trade unions and Government – when employment opportunities shrink. When this happens – as it did last year – the first need is to explore the causes. The business recession last year was a result in part of reduced government spending; this influence was counteracted by tax reductions. A second factor was a declining tendency in business expenditures for plant and equipment; this influence was counteracted by tax revisions designed to encourage business investment and by an easy money policy which helped boost total construction activity to a record level. A third factor was inventory contraction, a powerful but passing influence.

Inventory reductions, facilitated by sustained consumer spending, ran their course. Business volume, seasonal factors considered, has been on an upgrade for six months. Unemployment for January is reported at 3,347,000, up from 2,838,000 in December, and a little above the 3,230,000 reported average for 1954. Unemployment regularly rises in January, as the stores and post offices release help taken on to handle the Christmas rush. Moreover, cold weather normally depresses employment in the winter.

The January 1955 figure is rather far from the highest unemployment total registered since World War II. It is 1,133,000 less than the 4,480,000 recorded for January 1950, following the 1949 business recession. At that time President Truman's annual Economic Report characterized the situation in the following language:

> As 1950 opens, renewed confidence prevails in the American economy. This confidence is in itself an element of strength; and it is justified by the facts.
>
> Late in 1948 we stood at the peak of the inflationary boom. It was clear that an eventual adjustment was inevitable before we would have a firm basis for stability and steady economic growth. During 1949 we met the test of that adjustment. Despite rough going for a few months, we made necessary changes with much less distress and difficulty than ever before. Today we are on firmer ground than we were a year ago.

With the addition of five years to the dates this statement is as true now as it was then.

That 1954 was not too rough a year is indicated by a report prepared by AFL staff economists for the meeting at Miami Beach. This report stated that higher hourly wages and stable living costs had given most workers their greatest postwar gains in purchasing power. For 1955 better business and substantial raises in pay were predicted – along with higher unemployment.

The threatened up-push of labor costs may itself insure the accuracy of the forecast of increased unemployment. When the mechanic asks too much the would-be employer may leave the job undone – or do it himself.

Normal Unemployment

With all the attention focussed on unemployment figures it is pertinent to take a closer look at what they are and how the current figures stand in the historical perspective. The accompanying chart presents estimates of the calculated unemployment percentage since 1900. These figures, for what they are worth, indicate that the unemployment percentage for 1954 (5.0 per cent) was below the average of the 1900-53 period which works out to 7.2 per cent. A comparison with previous peacetime experience is even more striking. If ten war years (1917-18; 1942-45; and 1950-53) are left out of account, the unemployment percentage for forty-four peacetime years comes out to 8.4 per cent. If the eleven years of deep depression (1921 and 1931-40) are also eliminated, we get an average for thirty-three non-depressed peacetime years of 4.3 per cent.

The 5 per cent for 1954 is certainly far removed from anything that can be properly regarded as demanding emergency measures. It is 1 per cent below the 6 per cent which Senator Douglas, an expert on labor statistics, has called the point at which an unbalanced federal budget may be justified to support employment opportunities. This standard provides no excuse for the present federal deficit, to say nothing of a bigger deficit urged by the advocates of overfull employment.

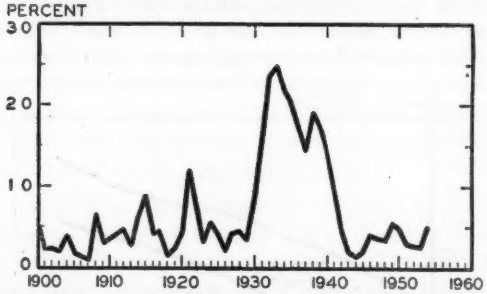
Charles P. Taft, distinguished lawyer, churchman, and labor relations consultant, gave a reasoned evaluation of the unemployment percentage in *Fortune* last month:

Obviously it is quite impossible for all persons who want to work to be immediately and simultaneously employed. A certain number of people are always sick, shifting jobs, shifting residences, ceasing to work, beginning to work. This is frictional unemployment. What percentage of the total work force should it represent? Is the present ratio – a little under 5 per cent – too high?

Experience indicates that when unemployment falls much below 5 per cent, and beyond doubt when it falls below 2½ per cent, the availability of many skills in many areas approaches zero. This obviously hurts the economy. It sets up an inflationary force greater than can be compensated by increasing productivity, and the higher prices that result come out of the pockets of those who are working.

A modest amount of frictional unemployment is the price of labor mobility. It was clearly good for New England that in fifteen years it lost 70,000 jobs in textiles while it gained over 400,000 in machine shops, electronics, aviation, etc. United Aircraft, when it was expanding, decided to stay in Connecticut to tap the pool of broadly skilled labor there. And a business bought recently in Ohio was moved back to its purchaser's plant in New England. This is typical of America, and I believe it will continue to be.

Actually, if we can keep unemployment from 1955 to 1980 at 4 to 5 per cent of the labor force, it will be an extraordinary accomplishment, especially after 1960 when the bumper crops of babies born during the last twelve years begin to flood the labor market.



Unemployment as a Percentage of the Civilian Labor Force, 1900-1954

Source: Staff of the Joint Committee on the Economic Report, "Potential Economic Growth of the United States during the Next Decade", October, 1954. Figures for 1940-54 are those of the Bureau of the Census.

Values in Leisure

The 3.2 million average unemployment level in 1954, it is relevant to note, falls not only below Senator Douglas' critical 6 per cent point, but also below some older conceptions of what is the lowest percentage we are apt to be able to realize in practice. In April 1937, according to *The New York Times,* officials of the Works Progress Administration expressed the thought that there always would be at least 4 million unemployed in the United States even at the peak of prosperity. That year, with an unemployment level more than double the 1954 figure, the Secretary of Commerce took satisfaction in figures of tourist activities as a "definite indication of the happiness and prosperity of the American people". The crowded highways suggested that people were also getting a lot of satisfaction out of their periods off the job during 1954.

Only in war do we have fullest employment. Every able-bodied man and woman is needed. But war, with all its demands for labor and high wage offers, does not bring true prosperity; while it tests the emergency capacity of the nation to produce, it imposes sacrifices not only of lives but also of goods for civilian consumption, of educational programs, and of opportunities for people to relax and enjoy themselves.

Indeed, even in time of hectic peacetime boom, there are losses to home-life, leisure and education as women who might better be at home raising their families and students who might better stay in school are tempted by the abundance of jobs to go to work. If "jobs for all" and avoiding every wastage of labor were proper objectives of economic life, we would repeal the child-labor laws, forbid strikes, and stretch the eight-hour day to twelve or fourteen. Is not a man's time worth something to himself?

If there is a clear lesson out of the chart it is the importance of avoiding deep depression – the 10 to 25 per cent range of unemployment. The present risk is that, in the effort to drive unemployment down, we will set in motion uncontrollable forces of inflation which will give us, in the end, a really serious increase in unemployment as the price of restabilization. It is one thing to be out of a job when any kind of work is scarce; it is another thing to be out of a job when reemployment demands no more than choosing from among alternatives offered.

Amid all the talk of an unemployment problem it is remarkable that no one calculates the totals of unfilled jobs. That such exist in large numbers is evidenced in the turnover statistics and the help wanted ads, to say nothing of the chronic shortages of domestic help.

Who Are the Unemployed?

At the hearings dissatisfaction was expressed from all sides with the concepts and accuracy of labor force and unemployment measures. In attempting to interpret the statistics, or to base public policy on them, it is essential to bear in mind that the figures are inevitably fuzzy around the edges. It is relatively easy to agree on a definition of employment: the line between having a job and not having a job is fairly clear cut. But it is quite another question to decide which of the people without jobs should be counted as members of an available labor force.

The Census Bureau gets its estimate of unemployment by interviewing a sample of 25,000 families in 230 areas of the country. As an illustration of the frailty of the data, the Bureau in January 1954 raised its estimate by 728,000 persons, attributing the difference to an improvement in sample and inadequacies in the supervision of interviewers. But beyond this, no one can say how many people tell the government representative they are unemployed but looking for work so that they will not jeopardize their unemployment benefits – or expose themselves as income tax evaders. In short, the dimensions of the unemployment percentage depend on the veracity as well as the frame of mind of the people questioned.

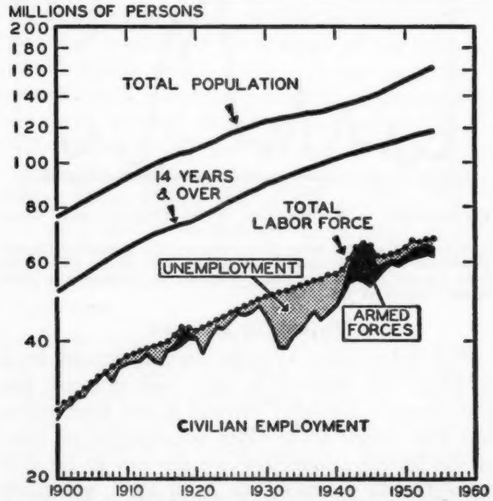
The current Census Bureau statistics include as unemployed all persons who claim they are willing, able, and seeking to work as well as certain others who are not actively hunting jobs because of illness or lack of what they consider to be suitable employment opportunities. This definition includes unemployed heads of families but also marginal labor – housewives interested in making some pin-money, retired persons hoping to supplement their pensions, and teen-agers looking for baby-sitting jobs. Not included as unemployed under the Census definition are workers with jobs but temporarily laid off, employees of firms operating short weeks, and persons who may be doing odd jobs while seeking full-time employment. All of these would currently be reported as employed.

In effect, there can be no strict definition of unemployment which will hold true for all purposes. At one extreme are persons who need work and are working hard at the job of finding a job. At the other are persons who would accept work if an attractive offer were made to them but are not making any real effort to find a position. In between these extremes are people who are seeking work with widely varying degrees of persistence and enthusiasm. Thus, unemployment is not just a measure of the failure of employers to provide enough jobs; it also reflects the fact that people often are choosey about the jobs they will take, willing to wait for what they want, and reluctant to change employer, occupation, or residence.

The Cart Before the Horse

In a letter to the editor of *The Journal of Commerce* on February 1, David McDonald, President of the United Steel Workers of America, subscribes to the view that "a substantial annual rise in output" is "not only possible but imperative, if the objective of sustained maximum employment is to be realized". The question is, does not Mr. McDonald have the cart before the horse? Is it the central function of an economic system to provide employment for as many people as can be cajoled into entering the labor force? Or is the function to gain maximum efficiency in the application of labor, to outwit the Malthusian principle that wars and famines must be relied upon for control of the pressure of population on world resources, and to give people, not only goods in proportion to their willingness to expend efforts to procure them, but also time for advancement by study and learning and leisure to relax from the hurried pace of modern life?

In the debate over unemployment sight is often lost of the actual levels of employment achieved. The second chart gives a long-term record of growth in population, in employment and in the available labor force. During World War II, when total employment including the armed services was pushed up to an abnormal 65 million, critics challenged industry to provide 55 to 60 million peacetime jobs. Average employment in 1954 was 63.6 million. The 1955 average seems to most observers to be headed higher. With good will and energy we can move forward



Long-term Growth in Population, Labor Force, and Employment
(Logarithmic scale to show proportionate changes)
Source: 1940-54, U.S. Bureau of the Census; 1929-39 U.S. Bureau of Labor Statistics; 1900-28, adapted by this bank from material in "Potential Economic Growth of the United States".

and not only produce, without extension of working hours, an abundant supply of goods and services to consume but also achieve a large addition to the capital supply of better homes, stores, offices, factories, schools and roads.

The sheer availability of jobs will not produce anything without a willingness on the part of people to go to work, to stick to the job at hand, and finish it. Under favoring political and financial conditions — such as we now enjoy — people have it within their own power to build up the employment and production totals.

Incentives for Employment

The height of present-day employment in many ways is surprising, considering the fact that Government (Federal, State and local) is making social welfare payments — from unemployment compensation and old-age pensions to soldiers' bonuses — at the incredible rate of $14 billion a year. And this is to say nothing of severance pay, pensions, and benefits provided by private employers, as well as savings accumulated by employees against the hazard of unemployment or to make a pleasant holiday out of a respite from punching the time clock. Despite these payments, which correspondingly reduce needs to work, we have more than 60,000,000 people working full or part-time. This is a reflection, among other things, of the aspirations of people, through work, to enjoy fuller lives and to provide better for their families. If, as some fear, production out-runs demand, the natural corollary would be a shrinkage in the proportion of the population employed and in work hours. People do not need to work to enjoy what they do not want.

There is, to be sure, another route for dealing with the alleged problem of overproduction: that is to raise unemployment compensation and to offer wage guarantees to a point that tempts more people to look the other way when job opportunities present themselves. We can afford to tide people over periods of economic adjustment. We cannot afford to make unemployment so attractive as to undermine the will to work.

As a matter of bald fact, unemployment, embodied in the phrase "financial independence", is a rather widespread human aspiration. Most people work in an organized way only because they have to or because they want to accomplish something, get ahead in life and raise the standard of their material welfare. The more a man can earn the easier it is for him to enjoy interludes between jobs, to take time off for fishing or working around the house, and to sustain himself during prolonged strikes. People in real poverty cannot afford unemployment. They have to take any job they can get.

Faith in People

In a critical review of Government economic policy last September, the AFL's Executive Council asserted:

> There is no evidence on the economic horizon that allows us to be complacent about the future. It may well be true that the next few months will see a strong improvement in business conditions; there is no reason to believe that such an improvement will occur automatically.

It is never wise to be complacent about the economic horizon. But faith in America has always paid off in the end. There was no reason last summer to believe that business would improve "automatically". No reason, that is, except faith — faith that people who wanted to work would seek, find and accept work; faith that business, in a little friendlier tax climate, would meet the challenge with increased sales efforts and raise and spend money to improve production and product; faith that the people at large would want to sustain their own employment opportunities and living standards by keeping up their personal outlays within their collectively abundant means.

These faiths were redeemed.

The President has wisely recognized the paramount importance of sustained confidence. His Economic Report, reviewing the record, stated:

> It is well to recognize, however, that the reasons for the success of recent policies are not to be found in them alone. Tax reductions, however attractive they may seem when the economy is declining, will not necessarily lead to an increase of spending or investing. Easier credit conditions, larger bank reserves, even a larger money supply will not necessarily put new money to work in industry. Management of the public debt so as to avoid competition with mortgages and other capital issues will not necessarily increase private capital formation. If such policies are to be of material help in stemming a contraction, there must be a pervasive feeling of confidence on the part of people.
>
> The effectiveness of a particular policy, whatever be its sphere or expression, is conditioned by the mood of the time, and this is bound to reflect people's attitudes toward governmental policies at large. It is not merely the intrinsic merit of the individual policies that were pursued, but also the fact that each was part of a cohesive program for strengthening the confidence of people in their own and their country's economic future, that accounts for our recent success in curbing economic contraction.

How much or little unemployment we have in 1955 will be dependent upon a multitude of influences, not least of which will be the preservation of a climate where industry and initiative find rewards, the willingness of people who want work to move where the jobs are, and the willingness of people with savings to commit them in long-term investments.

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